

DEPRECIATION EXPENSE

Note: The following questions and answers were formulated using ASBO International's GASB Statement No. 34 Implementation Recommendations for School Districts (hereafter, referred to as ASBO's Implementation Recommendations). OPI supports ASBO's recommendations and encourages the use of this publication for further information and guidance. Other resources are GASB Implementation Guides (see GASB website at <http://www.gasb.org/repmodel/index.html>) and the AICPA (September 2002) Audits of State and Local Governments (GASB 34 Edition).

Q: What steps must a district take to ensure that recognition of depreciation expense complies with GASB 34?

A: ASBO recommends districts perform the following tasks to prepare for recognition of depreciation:

1. Review current fixed asset records to determine the current level of compliance.
2. Determine if there is a need to re-define fixed assets (e.g. consider capitalization threshold).
3. Decide what assets will be included on the inventory of fixed assets in service as of June 30, 2001 (effective date of GASB 34).
4. Review recent capital maintenance projects to determine those that should be capitalized.
5. Examine the historical or estimated historical cost for all fixed assets.
6. Determine the year of purchase and the estimated useful life for existing fixed assets.
7. Establish procedures to maintain the fixed assets and depreciation system.
8. Determine the amount of accumulated depreciation at the implementation date and the amount of depreciation expense for the current year.
9. Determine the salvage value for each asset, if any.

Q: How many years prior should a district review in determining whether or not major building improvement projects should be capitalized under GASB 34?

A: ASBO recommends a review of projects for the last three to five years unless meaningful information is easily obtainable for prior years.

Q: GASB 34 requires reporting of "infrastructure assets". How does that apply to schools?

A: Schools will generally have no infrastructure assets required to be reported. Infrastructure assets include roads, bridges, etc. that are not common assets for districts to own.

Q: Are schools required to begin capitalizing items purchased in large quantities, such as library books, textbooks and computers?

A: Items such as library books, textbooks and computers typically do not meet the capitalization policy of a district if the individual cost is considered. However, districts may choose to capitalize these assets as groups. OPI agrees with ASBO's recommendation that, if these items were purchased with debt proceeds, they should be capitalized as groups and added to the capital assets inventory. This will make sure that the debt will be offset with the corresponding asset on the Statement of Net Assets.

Q: How should a district determine the useful life of an asset?

A: OPI endorses use of the table below and recommends that districts amend their current capitalization policy to include procedures for determining the useful life of an asset.

| Asset Class | Examples | Est. Useful Life in Years |
|--------------------------|--|----------------------------------|
| Land | | N/A |
| Site Improvements | Paving, flagpoles, retaining walls, sidewalks, fencing, outdoor lighting | 20 |
| School Buildings | | 50 |
| Portable Classrooms | | 25 |
| HVAC Systems | Heating, ventilation, and air conditioning systems | 20 |
| Roofing | | 20 |
| Interior Construction | | 25 |
| Carpet Replacement | | 7 |
| Electrical/Plumbing | | 30 |
| Sprinkler/Fire System | Fire suppression systems | 25 |
| Outdoor Equipment | Playground, radio towers, fuel tanks, pumps | 20 |
| Machinery & Tools | Shop and maintenance equipment, tools | 15 |
| Kitchen Equipment | Appliances | 15 |
| Custodial Equipment | Floor scrubbers, vacuums, other | 15 |
| Science & Engineering | Lab equipment, scientific apparatus | 10 |
| Furniture & Accessories | Classroom and office furniture | 20 |
| Business Machines | Fax, duplicating and printing equipment | 10 |
| Copiers | | 5 |
| Communications Equipment | Mobile, portable radios, non-computerized | 10 |
| Computer Hardware | PCs, printers, network hardware | 5 |
| Computer Software | Instructional, other short-term | 5 to 10 |
| Computer Software | Administrative or long-term | 10 to 20 |
| Audio Visual Equipment | Projectors, cameras (still and digital) | 10 |
| Athletic Equipment | Gymnastics, football, weight machines, wrestling mats | 10 |
| Musical Instruments | Pianos, string, brass, percussion | 10 |
| Library Books | Collections | 5 to 7 |
| Licensed Vehicles | Buses, other on-road vehicles | 8 |
| Contractors Equipment | Major off-road vehicles, front-end loaders, large | 10 |

| Asset Class | Examples | Est. Useful Life in Years |
|------------------|---------------------------------|---------------------------|
| | tractors, mobile air compressor | |
| Ground Equipment | Mowers, tractors, attachments | 15 |

Q: What other considerations should the district make in reviewing its capitalization policy?

- A: OPI agrees with ASBO's recommendation that a school district's capitalization policy should include a capitalization threshold of not more than \$5,000, and ensures that at least 80 percent of the value of assets is reported. In addition, capitalization of assets purchased with debt proceeds should be carefully considered so that the reported debt is offset by an asset. This may minimize the possibility of reporting a negative balance for unrestricted net assets on the Statement of Assets.

Q: GASB 34 requires depreciation expense to be listed by function. How should a district report depreciation of a building that serves multiple functions? What method should be used to allocate the depreciation?

- A: Depreciation expense is reported on the Statement of Activities, on the district-wide financial statements and on the proprietary statements. GASB 34 requires that depreciation for assets specifically identified with specific functions is to be included in the direct expenses of those functions. However, fixed assets that serve essentially all functions, such as a high school, are reported on:
- a separate line, or
 - as part of the general administration (or its counterpart) function.

(Note that if depreciation is reported as a separate line item, the face of the statement must clearly indicate that this line item excludes depreciation expense charged to functions for assets specifically identified with those functions.)

ASBO recommends not allocating the depreciation of a building that serves multiple (i.e., more than just a few) functions. However, if the district chooses to allocate, ASBO recommends that the allocation be based on square footage for the time used.

Q: What method of depreciation should be used?

- A: While GASB 34 does not require the same depreciation method for all capital assets, OPI recommends use of the straight-line method of depreciation.

Q: How should depreciation be calculated for assets placed in service or disposed of on a specific date during the month?

- A: Generally Accepted Accounting Principles (GAAP) supports the use of averaging conventions to avoid having to depreciate each asset from the specific date on which it was placed in service or disposed of. There are five averaging conventions as described below (ASBO recommends use of the full-month convention):

Full-month convention – Property is treated as being placed in service on the first day of the month, regardless of the actual day of the month its use began. Depreciation is taken for the entire month. If the asset is disposed of before the end of its useful life, no depreciation is taken in the month of disposition.

Half-year convention – Asset is treated as being placed in service on the first day of the seventh month of the fiscal year, regardless of when during the year it was actually placed in service. For grouped assets, such textbooks and computers, which are purchased throughout the year, this may be a more appropriate method.

Modified half-year convention – An asset purchased during the first half of the year is treated as being placed in service on the first day of the fiscal year. If purchased in the second half of the year, the asset is treated as having been placed in service on the first day of the following fiscal year. This is more complicated method and should be used with caution when applying to large capital assets because of the potential for misstatement of asset values and depreciation.

Mid-month convention – Assets are treated as being placed in service or disposed of in the middle of the month. A half-month of depreciation is allowed in the month of acquisition and in the month of disposal.

Mid-quarter convention – Assets are treated as being placed in service or disposed of in the middle of the quarter in which the transaction takes place.

Q: What is depreciable cost?

A: Depreciable cost is the amount of an asset's value that will be used for depreciation. Often times, the depreciable cost of an asset is its purchase price; however, if the asset is obtained through a means other than cash, then the fair-market value of the non-cash consideration is used to determine its depreciable cost. Other items that affect depreciable cost are costs incurred to place the asset in service, such as freight, insurance during transit, capitalized interest, duties, title search and registration fees and installation. Some expenses incurred in the acquisition of the property, such as interest expenses associated with deferred payments and real estate taxes not included in depreciable cost.

Q: What is salvage value?

A: The salvage value of an asset is the asset's estimated remaining value at the end of its expected useful life. Salvage value is subtracted from an asset's acquisition value to determine depreciable cost under the straight-line method of depreciation.